ORIGINAL

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Price Cap Performance Review for Local Exchange Carriers;	)	CC Docket No. 94-1
Treatment of Video Dialtone Services Under Price Cap Regulation	)	

COMMENTS OF COX ENTERPRISES, INC.

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SUMMARY

A LEC that provides video programming in conjunction with wireline transport directly to end users is a cable operator subject to Title VI of the Act. Telephone companies that provide video programming directly to subscribers are "cable operators" providing "cable service," as those terms are defined by Title VI. Moreover, treatment of LEC video programming and facilities as Title VI service is the best way to achieve the Commission's goals of regulatory parity between similar services and prevention of cross-subsidization.

Allowing LECs to provide video programming and facilities within an existing price cap basket would not only fail to advance the Commission's stated public interest goals for video marketplace competition and price caps but would actually hinder them. The Commission must find that a new service is functionally equivalent to an existing service in order to conclude that it should be placed within an existing price cap basket. Because customers do not perceive LEC-owned video programming as a product functionally equivalent to any existing price cap services, the Commission cannot conclude that LEC video offerings belong within an existing price cap basket.

Placement of LEC video offerings within an existing price cap basket would not advance the Commission's goals for video dialtone. Allowing LECs to offer what is essentially cable service as cable operators under the current price cap regime would provide LECs with an artificial advantage in their network rebuild project. As the video dialtone tariffs that already have been filed attest, treatment of LEC video network investments within the current regulatory framework will facilitate the massive misallocation of common costs away from LEC video service subscribers to telephone ratepayers.

The Commission must apply a rational cost allocation method to LEC video offerings. Applying the "new services" cost-allocation approach to LEC video ventures blurs the critical distinction between a LEC's decision simply to configure its network to provide a new type of transport service and a LEC's decision to rebuild its network optimized for video service delivery. When the LEC network is built to be optimized for the delivery of video programming, an honest and accurate appraisal of the "incremental" nature of this investment is required.

The price cap model is ill-equipped to address improper shifting of LEC video network costs onto regulated telephony ratepayers. Accordingly, the Commission must apply additional protections to prevent this conduct. The Commission must ensure that any separate price cap basket created for LEC video offerings meets the following criteria: (i) employment of Part 64 cost allocation methods; (ii) the productivity factor must be kept at zero; and (iii) any sharing obligations should be limited to the LEC video basket without unified sharing across baskets.

No productivity factor should be assessed against a LEC video price cap basket in order to reflect the unsettled state of, and the Commission's relative inexperience with, current LEC video offerings. A productivity factor set at zero will also compensate for the likelihood that LECs will seek to underprice their video offerings. In order to minimize the opportunity for LECs to manipulate the sharing and low-end adjustment mechanisms to engage in cross-subsidization, the Commission must also require that no unified sharing across baskets will be allowed with respect to a price cap basket for LEC video offerings.

The Commission must regulate LEC video programming and facilities as what they truly are -- cable service over a cable system subject to Title VI. If the Commission is determined to establish a separate price cap basket for LEC video offerings, it must plainly identify what types of investments belong in that basket. Simple extension of current price cap rules to LEC video investments will fail to protect ratepayers from massive cross- subsidies.

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COMMENTS OF COX ENTERPRISES, INC.

Cox Enterprises, Inc. ("Cox"), by its attorneys hereby files its comments in response to the Commission's Further Notice of Proposed Rulemaking in the above-captioned proceeding to determine whether to create a separate price cap basket for video dialtone services.[1/]

I. INTRODUCTION

The Commission seeks comment in this *Notice* on whether to establish a separate price cap basket to encompass "video dialtone" services provided by price cap local exchange carriers ("LECs"). Because recent court decisions[2/] have authorized telephone

1/ *Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services Under Price Cap Regulation*, CC Docket No. 94-1 (released February 15, 1995) (the "*Notice*").

2/ *See, e.g., Chesapeake & Potomac Tel. Co. of Virginia v. United States*, No. 93-2340 (4th Cir. November 21, 1994); *U S West, Inc. v. United States*, No. 94-35775, D.C. No. CV-93-01523-BJR (9th Cir. December 30, 1994); *Bell South Corp. v. United States*, No. CV 93-B-2661-S (N.D. Ala. September 23, 1994); *Ameritech Corp. v. United States*, 867 F. Supp. 721 (N.D. Ill. 1994); *NYNEX Corp. v. United States*, Civ. No. 93-323-P-C (D. Me. December 8, 1994).

companies to provide video programming over their own video facilities in their own service areas, however, the very "bedrock common carriage" nature[3/] that the Commission originally envisioned "video dialtone" to be has been irretrievably called into question. Under the plain language of the statutory definition of a cable operator, it is axiomatic that, when a LEC provides video programming directly to end users, as Cox noted in its comments on the *VDT Fourth Further Notice*,[4/] it is a cable operator subject to Title VI and any video service it provides to subscribers is cable service. Not only is LEC video programming a cable service, the LEC's video network used to transmit programming is a cable facility.

Title II price cap regulation, therefore, does not apply to LEC provision of video programming and associated video facilities. This is because the Commission has yet to identify precisely the scope, nature and type of Title II obligations that should apply to that portion of a LEC's video dialtone platform that it does not program.[5/] It therefore is premature to decide that price caps offers an appropriate regulatory framework for the "common carriage" portions of a LEC's video dialtone facility. It is even more compelling

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3/ *See Telephone Company-Cable Television Cross-Ownership Rules, Sections 63.54-63.58*, Second Report and Order, Recommendation to Congress, and Second Further Notice of Proposed Rulemaking, 7 FCC Rcd 5781 (1992) (*Video Dialtone Order*), *appeal pending sub nom., Mankato Citizens Telephone Company v. F.C.C.*, No. 92-1404 (D.C. Cir. filed September 9, 1992), and *modified on recon.*, 10 FCC Rcd 244 (1995) (*Video Dialtone Reconsideration Order*).

4/ *See Telephone Company-Cable Television, Cross Ownership Rules, Sections 63.54-63.58*, CC Docket No. 87-266, Fourth Further Notice of Proposed Rulemaking (released January 20, 1995) (*VDT Fourth Further Notice*).

5/ Even that portion of its video network that a LEC provides to unaffiliated programmers, in Cox's view, is properly regarded as leased access, to be regulated under Title VI rather than under some type of Title II platform.

that the telephone industry (or at least the Chairman of Bell Atlantic) agrees with cable companies that price cap regulation should not apply to LEC video offerings.[6]

Even assuming LEC provision of video programming directly to end users is a Title II service, it should be regulated under Part 64 cost-allocation regime to provide adequate safeguards against the very real prospect of regulated telephone customers paying for the rebuild of LEC networks optimized for video programming delivery. Only this result would advance the Commission's stated goals for video dialtone and price caps. Finally, if the Commission adopts a separate price cap basket for video dialtone, such a basket would fail to achieve its purpose of ensuring competitive delivery of video services unless: (i) the Commission employs fully allocated cost rules, instead of the price caps "new services" test; (ii) the productivity factor is set at zero; and (iii) there is no sharing across baskets.

6/ Bell Atlantic's Chairman recommends that the Commission should not adopt a separate price cap basket for LEC video offerings because rate regulation "would constrain artificially our ability to lower or raise rates to meet competition." *See* Letter from Raymond W. Smith, Chairman, Bell Atlantic Corporation, to Reed Hundt, Chairman, Federal Communications Commission (March 7, 1995). Cox agrees that price caps should not apply to LEC video offerings but for different reasons: As demonstrated in a reply to Smith's letter submitted by the President and CEO of Cox, LEC video offerings pose serious anticompetitive threats (including a potential annual cross-subsidy in Bell Atlantic's video ventures of $2.6 billion for all households in Bell Atlantic's service area) that require heightened regulatory scrutiny not readily available under price caps. *See* Letter From James O. Robbins, President & CEO, Cox Communications, Inc., to Reed E. Hundt, Chairman, Federal Communications Commission (March 30, 1995).

II. LEC PROVISION OF VIDEO PROGRAMMING IN CONJUNCTION WITH VIDEO TRANSPORT DIRECTLY TO END USERS IS A CABLE SERVICE SUBJECT TO TITLE VI, AND NEITHER TITLE II IN GENERAL NOR PRICE CAPS IN PARTICULAR IS APPLICABLE.

A LEC that provides video programming directly in conjunction with wireline transport to end users is a cable operator subject to Title VI of the Act. As demonstrated in Cox's comments in the video dialtone docket, and almost uniformly supported by others therein, telephone companies that provide video programming to subscribers are "cable operators" providing "cable service," as those terms are defined by Title VI. Therefore, they are subject to the provisions of Title VI that apply to such entities.

A cable operator is a person that provides "cable service" over a "cable system."[7/] The term "cable service" means:

> (A) the one-way transmission to subscribers of (i) video programming, or (ii) other programming service, and (B) subscriber interaction, if any, which is required for the selection of such video programming, or other programming service.[8/]

Telephone companies undoubtedly intend to transmit "video programming" to subscribers. In *NCTA v. F.C.C.*, the United States Court of Appeals upheld the Commission's view that telephone companies providing video dialtone (but not their own programming) were not cable operators providing cable service because such telephone companies were not "engaged in the 'transmission . . . of video programming,'" which would require "active participation

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7/ 47 U.S.C. § 522(5).

8/ 47 U.S.C. § 522(6).

in the selection and distribution of video programming."[9/] When telephone companies provide their own programming, however, they *do* actively participate in the selection and distribution of programming and therefore *are* providing cable service.[10/]

Moreover, treatment of LEC video programming as a Title VI service is the best way to achieve the Commission's goals of regulatory parity between similar services and prevention of cross-subsidization. The Commission's establishment of a separate price cap basket for LEC video services would inappropriately place LECs offering video services under a disparate regulatory framework from similarly situated cable operators. This is plainly contrary to the dictates of regulatory parity and the Commission's goal of achieving competitive delivery of video services. By requiring at the outset that LECs separate video costs and investment and provide video services separately from telephony, application of Title VI regulation to LEC video offerings and facilities, as opposed to adoption of a price cap regime, also provides many of the necessary protections against the serious threat of LEC cross-subsidization of video ventures through their telephony rate bases.

9/ *NCTA v. F.C.C.*, 33 F.3d 66, 73 (D.C. Cir. 1994).

10/ The mere fact that other programmers may *also* provide cable service over the video dialtone platform does not change this fact. Nothing in the court's decision suggests that, to be engaged in the provision of cable service, an entity must be the *sole* provider of programming on a facility. If that were the case, traditional cable operators that leased several channels to unaffiliated programmers pursuant to their leased access obligations while programming the remaining channels themselves would not be providing cable service and would not be required to obtain franchises.

III. NEITHER THE PRICE CAP SYSTEM AS A WHOLE NOR A SEPARATE PRICE CAP BASKET IN PARTICULAR PROVIDES A SUFFICIENT FRAMEWORK TO ENSURE THAT LECS DO NOT CROSS-SUBSIDIZE THEIR VIDEO NETWORKS.

The Commission seeks comment in this proceeding on whether creation of a separate price cap basket, to prevent telephone companies from improperly cross-subsidizing price reductions in video services while increasing, or failing to reduce, rates for other regulated interstate services, would advance the public interest objectives that underlie its system of price cap regulation and video dialtone rules. If the Commission allows LECs to offer video programming and video facilities under any price cap regime, however conceived, it would multiply LEC opportunities to game the regulatory system and engage in anticompetitive conduct. Creation of a separate price cap basket for LEC video ventures would present a small obstacle to cost misallocation in the face of LEC monopoly power in the telecommunications market generally. Adoption of a separate price cap basket not only would fail to advance the Commission's stated public interest goals for video dialtone but it would hinder them.

A. If the Commission Decides to Regulate LEC Video Offerings Under Price Caps, Placing LEC Provision of Video Programming and Other Video-Related Facilities in an Existing Basket Would Not Advance the Commission's Goals for Price Caps.

The Commission's goals for price caps are to promote economic efficiency, ensure reasonable nondiscriminatory rates and reduce administrative costs.[11] The Commission adopted price cap regulation to improve traditional rate-of-return regulation for

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11/ *See Notice*, at ¶ 8.

telephone companies and to adapt to changes in communications technology, market structures and services.[12] Because rate-of-return regulation prescribes a rate based on a carrier's ability to recover its expenses plus a "reasonable" rate of return on investment, rate-of-return regulation encourages carriers to act anticompetitively by padding their books and subsidizing the costs of competitive ventures by improperly shifting those costs to customers of non-competitive services.[13] Rather than focusing on costs and profits, price cap regulation focuses directly on prices. In doing so, price cap regulation is believed to replicate marketplace forces of competition better than rate-of-return regulation. The Commission decided to move to a price cap system of regulation because it believed such a system could create profit incentives similar to those in fully competitive markets.[14]

12/ *See Policy and Rules Concerning Rates for Dominant Carriers*, Report and Order and Second Further Notice of Proposed Rulemaking, CC Docket No. 87-313, 4 FCC Rcd 2873 (1989) (*AT&T Price Cap Order*), *modified on recon.*, 6 FCC Rcd 665 (1990) (*AT&T Price Cap Reconsideration Order*); Revision to Price Cap Rules for AT&T, Report and Order, CC Docket No. 93-197 (*Commercial Services Order*); *see also Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, CC Docket No. 87-313, 5 FCC Rcd 6786 (1990) (*LEC Price Cap Order*), Erratum 5 FCC Rcd 7664 (Com. Car. Bur. 1990), *modified on recon.*, 6 FCC Rcd 2637 (1991) (*LEC Price Cap Reconsideration Order*), *aff'd, National Rural Telecom Ass'n v. F.C.C.*, 988 F.2d 174 (1993); *Price Cap Performance Review for Local Exchange Carriers*, First Report and Order, CC Docket No. 94-1, FCC 95-132 (released April 7, 1995) (*LEC Performance Review Order*).

13/ *See LEC Performance Review Order*, at ¶¶ 27-9.

14/ Although market-based incentives purport to make price caps a better system of regulation than rate-of-return, the Commission nonetheless relied heavily on its extensive experience with rate-of-return regulation in initiating the price cap system. The *Notice* indicates that the July 1, 1990 interstate access rates reported under rate-of-return regulation were deemed to be the "most reasonable basis from which to launch a system of price cap regulation" and to set the initial price caps indexes (PCIs) because these rates:

(continued...)

At present, price cap LECs are required to divide access rate elements of their various interstate services among four baskets: common line; traffic sensitive; trunking; and interexchange.[15] Actual aggregated price levels of services grouped within each of these price cap baskets (also called the actual price index or "API") may not exceed the ceiling or go below the floor of the price cap index (PCI) applicable to that basket.[16] The formula by which the PCI is derived consists of three main elements: an inflation factor; a productivity offset; and exogenous costs.[17] The inflation factor is based on the Gross National Product Price Index (GNP-PI). The productivity offset, which is subtracted from the inflation factor, reflects the amount by which LEC productivity gains are expected to exceed productivity

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14/ (...continued)

> were the culmination of a *six-year history of developing, refining, and overseeing the Commission's administration of rate of return regulation* . . . . cost allocation procedures to separate nonregulated costs from the combined regulated from [] combined regulated and nonregulated costs . . . . [and] a tariff review process that ensured that the Common Carrier Bureau had usable and reliable cost support in reviewing a LEC's annual access charges.

See Notice, at ¶ 17 n.41, *citing LEC Price Cap Order*, 5 FCC Rcd at 6814 (emphasis added). The Commission has no similarly extensive and well-developed tradition of rate-of-return regulation, cost-allocation methodology, and tariff review procedure upon which to base a price cap system of regulating LEC video offerings.

15/ *See LEC Price Cap Order*, 5 FCC Rcd at 6811; *see also Transport Rate Structure Pricing*, 9 FCC Rcd 615, 622-3 (1994) (*Transport Second Report and Order*).

16/ *See LEC Price Cap Order*, 5 FCC Rcd at 6811.

17/ The formula for the PCI associated with the common line basket is different because the actual costs of common line service are non-traffic sensitive, although a portion of the costs are recovered through rates that are traffic sensitive. *See LEC Price Cap Order*, 5 FCC Rcd at 6767, 6794-95.

gains in the economy as a whole. The resulting figure is also adjusted for a limited set of exogenous cost changes, generally those attributable to administrative, legislative or judicial action beyond the carrier's control and not otherwise reflected in price cap calculations.

The Commission previously based its decision to create separate price baskets on an analysis of whether a new service possesses unique characteristics, such as technology or level of competition in its service market, not shared by services in existing baskets.[18/] Placing dissimilar services in separate price caps baskets is intended to mitigate a LEC's ability to cross-subsidize among baskets because cost changes in one basket theoretically do not move in relation to costs associated with services in another basket.

If the Commission decides to regulate LEC video offerings under price caps, it must create a separate price cap basket because LEC video offerings are not similar to services in existing baskets. As the *Notice* correctly indicates, moreover, the technical and competitive characteristics of "video dialtone" are not similar to any services in existing price cap baskets.[19/]

18/ The Commission concluded in the *LEC Price Cap Order*, for example, that it was necessary to establish a separate price cap basket for interexchange services because such offerings were found to be "fundamentally different" from special access services, and:

> [p]lacing two very different services, with different sets of customers, in the same basket is a result [the Commission has] attempted to avoid due to the cross subsidy issues that might arise.

See LEC Price Cap Order, 5 FCC Rcd at 6812.

19/ *See Notice*, at ¶ 11. Additionally, the ability of LECs to provide video programming over their own video facilities, presents an additional dissimilarity of "video dialtone" from services in existing price cap baskets.

The United States Court of Appeals has held that the test for determining whether two services are similar is whether they are functionally equivalent.[20] In *Ad Hoc* the Court explained that:

> [t]he focus of the test should be practical, oriented to customers: what function or need do customers perceive to be satisfied by the services under examination? If customers perceive that two services perform the same function, price will govern choice. Sensibly, the functional equivalency test should be allowed to yield a determination that these services are "like," whether or not they are "identical," and we so hold.[21]

Under the functional equivalency test articulated by the Court of Appeals, the Commission cannot conclude that LEC video offerings are similar to any existing service under price caps.

BellSouth asserts in its comments in the *Video Dialtone Reconsideration* proceeding that LEC video offerings are basically a transport service that will fit comfortably into existing price cap baskets depending upon how the service is offered.[22] Existing transport services are included in the trunking basket. A "transport" service is a component of the LECs' interstate switched access service that enables interexchange carriers and other customers to originate and terminate interstate switched telecommunications traffic.[23]

20/ *See Ad Hoc Telecommunications Users Com. v. F.C.C.*, 680 F.2d 790, 797 (D.C. Cir. 1982) (*Ad Hoc*).

21/ *Ad Hoc*, 790 F.2d at 797.

22/ *See Notice*, at n.39.

23/ "Transport" refers to the local transmission service between customer points of presence (POPs) and LEC end offices, where local switching occurs. *See Transport Second Report and Order*, 9 FCC Rcd at 616 n.1; *see also 1994 Annual Access Tariff Filings*, 9 FCC Rcd 3705, 3718 (Com. Car. Bur. 1994).

A LEC offering video programming directly to subscribers is a cable operator and the video network through which it delivers the programming is cable service. In order for the Commission to find that LEC video offerings are functionally equivalent with existing transport services under the *Ad Hoc* customer perception test, therefore, each LEC would have to demonstrate that a cable subscriber would "perceive" LEC-owned video programming as a product to be functionally equivalent to a transport service that an interexchange carrier uses to transmit a customer's long distance call. There is obviously no comparison. A customer would perceive LEC video programming to have nothing in common with interexchange transport service.[24/] For the Commission to conclude that LEC video programming belongs in the transport category in the trunking basket or in any other existing price cap basket would be contrary to its legal and policy goals for price caps and inconsistent with the Court's customer perception test.

Nor would it be in the public interest to place LEC video services in a separate service category band within an existing price cap basket, in lieu of placing all LEC video offerings in a separate price cap basket. Under the price cap rules, pricing bands apply to each service category within a particular basket. The pricing bands limit the amount by which a carrier can raise or lower a rate without making a special showing.[25/] Tariff filings that propose rates within pricing bands (and at or below the price cap for the basket) are

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24/ Similarly, assuming LECs still intend to provide video transport services to unaffiliated programmers, a video programming customer is unlikely to perceive that LEC video services transport is functionally equivalent to some undefined set of transport service components already included in existing price cap baskets.

25/ *See* 47 C.F.R. §§ 1.773, 61.47.

reviewed on a streamlined basis, *i.e.*, on 14 days' notice, with a presumption of lawfulness. Above-band rates are filed on 90 days' notice and must be accompanied by a showing of substantial cause.[26] Below-band rates are filed on 45 day's notice and must be accompanied by a showing that the rates cover the average variable costs and are otherwise just, reasonable and nondiscriminatory. Service category bands therefore are designed to prevent cross-subsidization and predatory pricing *within* a basket.[27]

In the past, moreover, the Commission has subdivided price cap baskets into additional service category bands only after long experience with the competitive aspects and functional nature of these services. Only after continued experience with transport services did the Commission realign the division of services among baskets by combining transport and special access services into a newly-created trunking basket. The Commission decided to:

> mov[e] transport services out of the traffic sensitive basket and into a basket with special access services . . . [to] prevent the LECs from offsetting rate reductions for transport services subject to competition with rate increases for switching and other traffic sensitive services, which are subject to much less competition at this time.[28]

26/ *See* 47 C.F.R. §§ 1.773, 61.47.

27/ *See LEC Price Cap Order*, 5 FCC Rcd at 6788, 6811, 6813-14; *LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 617.

28/ *Transport Second Report and Order*, 9 FCC Rcd at 622. The six service categories within the trunking basket are: (1) voice grade flat-rated transport, voice grade special access, WATS, metallic, and telegraph; (2) audio and video; (3) high-capacity and digital data service (DDS); (4) wideband data and wideband analog; (50 tandem-switched transport; and (6) the interconnection charge. Within the high-capacity DDS service category are two subcategories for (i) DS1 special access and DS1 flat-rated transport and (ii) DS3 special access and DS3 flat-rated transport. *See id.* at ¶¶ 12, 21-3 (Flat-rated transport offerings at the voice grade,
(continued...)

At this time, the Commission lacks *any* information regarding the technical parameters and relative competitive pressures that bear on LEC video offerings sufficient to identify meaningful subclasses that should be placed in separate service category bands within a video basket. The widely divergent network architectures proposed in the carrier's Section 214 applications to date demonstrate the chameleon-like nature of the "video dialtone" concept. In its video platform in Dover, New Jersey, Bell Atlantic plans to implement a "fiber-to-the curb" architecture, with coaxial cable and copper wire for the final link to the home.[29/] Bell Atlantic claims that it was already committed to deployment of fiber optic networks under a plan called "Opportunity New Jersey" initiated by the New Jersey Board of Regulatory Commissioners to accelerate deployment of advanced technologies to achieve full broadband capability by 2010.[30/] Bell Atlantic's Dover network will transmit digital voice, data and video signals over the same fiber cable. Yet in Bell Atlantic's video market trial in northern Virginia it plans to implement an Asynchronous Digital Subscriber Line (ADSL) network architecture.[31/] In BellSouth's proposed video network in Chamblee and Dekalb Counties, Georgia, all of its analog capacity would be leased to a single programmer in a

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28/ (...continued)
DS1, and DS3 levels were incorporated into the corresponding voice grade, DS1 and DS3 service categories and subcategories for special access only after the Commission determined that flat-rated transport and special access are similar services provided over similar facilities and will be subject to similar competitive pressures).

29/ *See New Jersey Bell Telephone Company*, 9 FCC Rcd 3677, 3678.

30/ *See id.*

31/ *See The Bell Atlantic Telephone Companies, Tariff F.C.C. No. 10, Video Dialtone Market Trial in Northern Virginia*, Transmittal Nos. 742 and 765, DA 95-763 (Tariff Div. released April 7, 1995).

manner fairly characterized as nothing more than a glorified common carrier transport-type channel service, while leasing its digital capacity to other video programmers.[32] It would be anomalous for the Commission to institute service category banding, in lieu of creating a totally separate LEC video services basket, based on the ill-defined and still-evolving nature of LEC video offerings.

B. Placement of LEC Video Offerings in an Existing Price Cap Basket Will Not Advance the Commission's Goals for the Video Dialtone Proceeding.

The Commission also must evaluate whether establishing a separate video dialtone basket will advance its objectives, enunciated in the *Video Dialtone Reconsideration Order*, to facilitate competition in the provision of video services, promote efficient investment in the national telecommunications infrastructure, and foster the availability of new and diverse sources of video programming to the public. In the *Video Dialtone Reconsideration Order*, the Commission stated that a separate price cap basket for video dialtone would help prevent improper cross-subsidization by impeding local telephone companies from offering a price reduction for video dialtone service with an increase in rates for other regulated interstate services.

The placement of all video services offered by a LEC under an existing price cap basket would achieve none of the Commission's goals for video dialtone. First, allowing LECs to offer what is essentially cable service under an existing price cap basket and a price

32/ *See* Georgia Cable Television Association Petition To Deny (filed August 8, 1994) in *BellSouth Telecommunications, Inc.*, W-P-C-6977, DA 95-181 (released February 8, 1995).

cap regime that is moving swiftly towards deregulation would inappropriately place LECs under a disparate regulatory framework from their cable operator competitors. Placement of LEC video offerings in an existing basket would therefore fail to achieve regulatory parity between similarly situated service providers and would not facilitate "competition in the provision of video services."

It necessarily follows that placing some or all of LEC video offerings under the regime of Title II price caps within an existing price cap basket, while leaving similarly situated cable operators under a less favorable system of regulations, would promote only perverse investments in the national information infrastructure. Such disparate regulatory treatment would unjustly hinder investment by cable operators in emerging video technologies and unfairly reward telephone companies for gaming the system.

IV. IF THE COMMISSION ESTABLISHES A SEPARATE PRICE CAP BASKET FOR VIDEO PLATFORMS, SUCH A BASKET CANNOT ADEQUATELY PROTECT AGAINST LEC DISCRIMINATION AND OTHER ANTICOMPETITIVE CONDUCT UNLESS RULES ARE ADOPTED TO PREVENT SUCH CONDUCT.

If, contrary to Cox's recommendations, the Commission nevertheless creates a LEC video price cap basket, it must set the parameters of the basket in a manner calculated to reflect the strong likelihood that LECs will attempt to engage in cross-subsidization and other discriminatory conduct in offering video services. The Commission must ensure that any price cap basket it establishes for LEC video offerings meets the following criteria: (i) a rational cost allocation must be employed to mitigate the potential for cross-subsidization of LEC video and telephony services; (ii) the productivity factor associated with such a basket must be set at zero to reflect the present lack of information regarding the productivity of LEC video offerings; and (iii) no unified sharing obligations should be imposed on the video basket to mitigate misuse of sharing to cross-subsidize video ventures.

A. The Commission Must Adequately Protect Ratepayers by Requiring A Rational Cost Allocation of LEC Network Rebuilds.

The Commission must require LECs to allocate costs associated with telephony as a regulated service subject to Title II and LEC costs of video programming as a non-regulated service subject to Title VI using the principles of the Part 64 accounting rules.[33/] Part 64 is designed to identify costs associated with nonregulated services and to protect customers of regulated services from bearing costs associated with non-regulated services.[34/] Part 64 ensures that such cost identification and separation are accomplished by requiring common carriers to file and maintain individualized cost allocation manuals ("CAMs") and to conduct annual audits to demonstrate compliance with their CAMs and Commission rules.[35/] Application of Part 64 cost-allocation and accounting would greatly assist in ensuring a fair and equitable cost allocation among all ratepayers by separating the costs associated with LEC video services on the transport network as a non-regulated service from the costs of regulated

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33/ *Separations of Costs of Regulated Telephone Service From Costs of Nonregulated Activities,* Report and Order, 2 FCC Rcd 1298 (*"Joint Cost Order"*), *aff'd, Southwestern Bell Tel. Co. v. F.C.C.,* 896 F.2d 1378 (D.C. Cir. 1990).

34/ *See* 47 C.F.R. §§ 64.901 *et seq.*

35/ *Id.*

telephony service.[36] Moreover, treatment of all facilities operated by a LEC video programmer as cable facilities comports with the way the Commission has treated LEC ventures into the cable market in the past.[37]

Such treatment also has the virtue of consistency with the accounting treatment required of cable operators. Under the Commission's interim cost of service rules, cable operators are required to separate non-cable costs and revenues pursuant to Part 64 principles.[38] Because cable operators are required to separate costs and revenues associated with regulated telephone services from costs and revenues of regulated cable services, it would be both unfair and illogical not to require telephone companies to comply with the same cost allocation principles when they provide non-regulated services.

Fundamentally, the Commission's proposed cost approach to LEC video ventures under the "new services" test blurs the critical distinction between a LEC's decision simply to configure its network or add software to its switches to provide a new transport service and a LEC's decision to rebuild its network optimized for video service delivery. When a LEC network is built to be optimized for the delivery of vide programming, an honest and accurate appraisal of the "incremental" nature of this investment is required. As

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36/ The Commission's rules already require that LEC "basic" video dialtone platform costs be separated form LEC "enhanced" video services using Part 64. This separation alone, however, is insufficient to guard against massive cost misallocations.

37/ *See General Telephone Company of California*, Memorandum Opinion and Order, Order on Authorization, 4 FCC Rcd 5693 (1989) (requiring GTE to treat all costs associated with video facilities as unregulated activity costs in keeping with accounting rules adopted in the *Joint Cost Order*).

38/ 47 C.F.R § 76.924(e)-(f).

demonstrated in a recent study submitted in the New Jersey Bell Dover 214 proceeding, the cost-showing required by the "new services" test gives the LECs:

> strong incentives to underestimate video dialtone incremental cost, while less common cost may be allocated to video dialtone than intended in the Commission's adoption of particular allocation formulas. The critical challenge for the Commission is to assure that sufficient costs are, in fact, assigned to video dialtone to cover the "true" incremental costs (to avoid cross-subsidy) and to contribute to coverage of common costs in a manner deemed reasonable.[39]

Use of a rational Part 64 cost-allocation method will ensure that the *actual* numbers LECs assert in their Section 214 applications,[40] tariffs and related filings reflect an accurate separation of investment and costs associated with video programming and video facilities from those associated with telephony, and fairly allocate a reasonable share of common costs among regulated and nonregulated ratepayers to ensure that cross-subsidy does not occur.

B. The "New Services" Test is Inappropriate for LECs Rebuilding an Entire Service Network.

A brief survey of Commission decisions rejecting the fully distributed cost allocation methodology and applying the new services test in its place reveals that the unique policy and legal concerns associated with LEC participation in the video marketplace raise

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39/ *See* Leland L. Johnson, *Designing Safeguards Against Cross-Subsidization in Video Dialtone Services*, submitted in CC Docket No. 87-266 (October 3, 1994).

40/ Of course, only a LEC's independent cost-showing under Part 64 and at the tariff review stage would be relevant if the pending "Telecommunications Competition and Deregulation Act of 1995," which would abolish the Section 214 certification process for LECs providing video programming services, is adopted. *See* Pressler Bill, S. Rep. No. 104-23, 104th Cong., 1st Sess. 45 (1995).

problems fundamentally separate and distinct from those that convinced the Commission previously to apply incremental cost allocation. In the *OCP Guidelines Order*, the Commission first decided to replace fully distributed costing with a "net revenue test" because the historical or embedded costs upon which full distribution costing methods rely were found to be less relevant to business decisions than the current and anticipated costs upon which the net revenue test would rely.[41/]

The issue facing the Commission in the *OCP Guidelines Order*, however, was essentially different from the competitive concerns posed by LEC participation in the video marketplace. Specifically, the *OCP Guidelines Order* was intended to provide AT&T with additional pricing flexibility to offer consumers "optional calling plans or OCPs" -- which are volume and term discounts off of basic message telecommunications (MTS) service. An integral part of the Commission's conclusion that it should not apply fully distributed costing to OCPs was its finding that "AT&T is no longer operating in an environment in which it is the only carrier."[42/] The Commission therefore concluded that, with competition existing for the long distance OCP market, net revenue pricing would strike a reasonable balance between providing consumers with the benefits of competition and ensuring that AT&T would compete fairly.[43/]

41/ *See Guidelines for Dominant Carriers' MTS Rates and Rate Structure Plans*, 59 Rad. Reg. 2d (P&F) 70, 75 (1985) (*OCP Guidelines Order*).

42/ *OCP Guidelines Order*, 59 Rad. Reg. 2d at 81.

43/ *See id.* at 82.

In the Open Network Architecture (ONA) proceedings, the Commission replaced the net revenue standard with the current incremental-cost based standard for new LEC services.[44] The Commission held in the *ONA Safeguards Order* that adoption of an incremental cost-based new services test would advance the public interest by:

> providing LECs with an adequate incentive to innovate . . . [and to] permit[] them to earn a return on their total new investment commensurate with the risk they assume.[45]

The issues in this proceeding, unlike those facing the Commission in the *OCP Guidelines Order* and ONA proceedings, go to the heart of the cross-subsidy question. In order to provide video programming and related video facilities, a LEC must *rebuild its entire network.* Virtually all LEC proposals anticipate network rebuilds of hybrid fiber/coaxial networks optimized for video but meant for traditional telephony as well. Under the proposed framework, a LEC could allocate only an "incremental" portion of the network rebuild to its video services while apportioning the lion's share of upgrade costs to telephony ratepayers. As the Section 214 and tariff applications confirm, however, the LECs actually expect that the vast majority of these costs, the "common costs," are properly defrayed by the telephony ratepayers. Thus, the Commission must reassess the adequacy of current price cap cost

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44/ *See Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture: Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket Nos. 87-79, 87-313, Report and Order & Order on Further Reconsideration & Supplemental Notice of Proposed Rulemaking, 6 FCC Rcd 5424 (1991) (*Part 69 ONA Order*), *further recon.* 7 FCC Rcd 5235 (1992) (*Part 69 ONA Reconsideration*).

45/ *See Part 69 ONA Order*, 6 FCC Rcd at 4531.